



City of Detroit

OFFICE OF THE AUDITOR GENERAL

**Audit of the
Charles H. Wright
Museum of
African-American History**

November 2004



City of Detroit

OFFICE OF THE AUDITOR GENERAL

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Joseph L. Harris, CPA, CIA
Auditor General

Sharon L. Gipson, CPA
Deputy Auditor General

MEMORANDUM

DATE: April 28, 2005

TO: Honorable City Council
Mayor Kwame M. Kilpatrick

FROM: Joseph L. Harris
Auditor General 

RE: Audit of the Charles H. Wright Museum of African-American History

C: Christy Coleman, President/CEO

Attached for your review is our report on the audit of the Charles H. Wright Museum of African-American History.

This report contains our audit purpose, scope, objectives, and methodology; background; our audit findings and recommendations; noncompliance and other issues; and the agency's response.

We would like to thank the employees of the Charles H. Wright Museum of African - American History for their assistance.

Copies of all of the Office of the Auditor General's reports can be found on our website at www.ci.detroit.mi.us/legislative/CharterAppointments/AuditorGeneral.

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* The finding appeared in the prior Auditor General reports

AUDIT PURPOSE, SCOPE, OBJECTIVES, AND METHODOLOGY

Audit Purpose

The audit of the Charles H. Wright Museum of African-American History (Museum) was performed under authority granted in the City's operating agreement with the Museum. The Office of the Auditor General (OAG) performed an audit of the adequacy of control procedures to properly record transactions of cash receipts, payroll, disbursements, fixed assets, inventory, and imprest cash.

Audit Scope

The OAG performed an assessment of the Museum's control procedures for transactions of cash receipts, payroll, disbursements, fixed assets, inventory, and imprest cash for the period July 1, 2002 through October 31, 2003. We determined that there are certain weaknesses in the system of control. We focused our audit on the weaknesses identified during the assessment, and the status of the prior audit findings. The OAG expanded the scope of the audit as a result of the Museum's request to the City for emergency cash assistance to continue operations through the end of fiscal year 2003-2004. We performed additional financial analysis for the period April 1, 2004 through November 30, 2004.

Our audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States, except for the completion of an external quality review of the OAG within the last three years.

Audit Objectives

Our audit objectives were:

- To evaluate the adequacy of the Museum's internal controls over the major financial reporting processes;
- To determine whether the Museum implemented the prior audit recommendations or otherwise resolved the findings, and
- To evaluate whether the annual budgets prepared by the Museum were reasonable and to determine what factors changed the original budget projections.

Audit Methodology

To accomplish the audit objectives, our audit work included the following:

- A review of pertinent information related to the Museum;
- Interviews with appropriate Museum personnel;
- Observations and testing of internal control processes and procedures for cash receipts, payroll, disbursements, fixed assets, inventory and imprest cash;
- Examination of a sample of transactions that we considered satisfactory to achieve our objective; and
- Analysis of annual budgets and revenues and expenditures budget to actual statements.

BACKGROUND

The Charles H. Wright Museum of African American History is a nonprofit corporation that documents, preserves and educates the public on the history, life and culture of African Americans. Founded in 1965 by Dr. Charles H. Wright, the Museum serves as a resource center providing quality educational programs and exhibitions documenting the horror of slavery, the struggle for freedom, and the civil rights movement.

In 1999, the City entered into a long-term operating agreement with the Museum to manage and operate the facility, which also includes management and maintenance of the artifacts collection and presentation of exhibitions and other events. The Museum acts as an independent contractor of the City and, as such, has full authority to discharge its duties without restrictions, except for those imposed by the agreement. Under the terms of the agreement, the Museum petitions the City for operating funds each year. The Museum received operating funding from the City in the amount of \$1,805,000 for fiscal year 2003-2004 which was the same amount it received in fiscal year 2002-2003. In addition, near the end of fiscal year 2003-2004, the Museum received an emergency advance of its 2004-2005 appropriation of \$510,000 from the City. The advance was requested to help the Museum continue operations through the end of the fiscal year. The Museum's fiscal year 2004-2005 City appropriation was reduced to \$1,290,000, because of the emergency advance awarded in fiscal year 2003-2004.

Operating Revenue Sources

The Museum receives operating funds from paid admissions, memberships, facility rentals and catering, store sales, special events, private contributions, and City grants. For fiscal year 2003-2004, government sources accounted for an average of 31.5% of the Museum's total annual operating income of which, City funding comprised 28.8%. According to an American Association of Museums¹ (AAM), the median annual operating income for museums derived from government sources is 34.0%. The AAM also cites the median annual income resulting from investment is 10.0%. However, the Museum's median income from investment is 0.1%. The following schedule compares the Museum's operating income by source, as a percent of total operating revenue to median averages reported by the AAM.

<u>Sources of Operating Income</u>	<u>AAM Standard (median)</u>	<u>Museum Fiscal Year 2003-2004</u>	<u>Favorable (Unfavorable)</u>
Government Funding (includes City grant average funding of 28.8%)	34.0%	31.5%	2.5%
Private Funding (a)	30.0%	43.2%	13.2%
Earned Income (b)	26.0%	25.2%	(0.8)%
Investment Income	10.0%	0.1%	(9.9)%

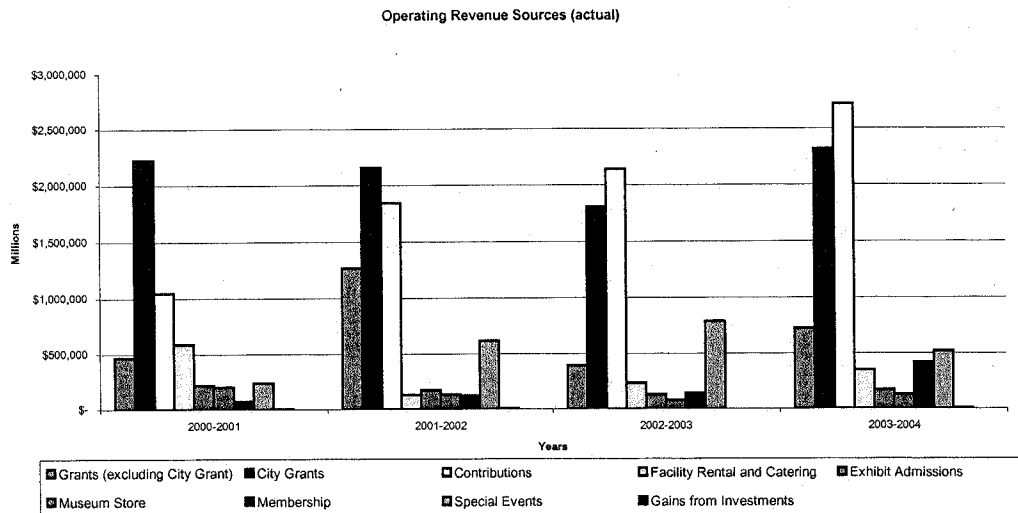
a) Private Funding includes Individual, Corporate and Foundation Contributions.

b) Earned Income includes Facility Rental, Catering, Admissions, Museum Store, Membership and Special Events and Other Revenue.

¹ 2003 Museum Financial Information, American Association of Museums

Membership and contributions for fiscal year 2003-2004 increased 193.1% and 26.7% respectively over fiscal year 2002-2003. These increases are primarily due to the Museum's grassroots appeal for funding toward the end of fiscal year 2003-2004. In July 2004, the Museum increased adult admission from \$5.00 to \$8.00 and youth admission from \$3.00 to \$5.00 to increase admission revenue.

The chart below compares the Museum's actual operating revenue for the fiscal years 2000-2001 through 2003-2004 per the audited financial statements. However, Museum personnel indicated that audited operating revenues for fiscal year 2003-2004 includes revenues totaling \$1,072,674 that should be classified as capital revenues.



Operating Expenditures

Operating expenditures exceeded revenues by \$1.9 million for fiscal year 2000-2001. By the end of fiscal year 2002-2003 the Museum reduced expenditures 18%. In fiscal year 2003-2004 the Museum's operating revenues exceeded expenditures by \$352,214, as a result of the Museum's intense fundraising and an outpouring of public support. If the Museum had not received the additional funding and the emergency advance of \$510,000 from the City, it could not have serviced its debt and continued operating through June 30, 2004. The schedule below illustrates operating net revenues over/(under) expenditures for fiscal years 2000-2001 through 2003-2004 as reported in its audited financial statements.

Operating Fund	2000-2001	2001-2002	2002-2003	2003-2004
Revenue including emergency City advance	\$ 5,062,051	\$ 6,445,210	\$ 5,711,432	\$ 7,347,341
Expenditures/Artifacts	<u>\$(7,018,329)</u>	<u>\$(6,728,840)</u>	<u>\$(5,749,624)</u>	<u>\$(6,995,127)</u>
Net Surplus/(Deficit)	<u>\$(1,956,278)</u>	<u>\$ (283,630)</u>	<u>\$ (38,192)</u>	<u>\$ 352,214</u>

However, Museum personnel indicated that operating revenues and expenditures for fiscal year 2003-2004 include non-operating revenues and expenditure totaling \$1,072,674 and \$1,010,755, respectively. After the misclassified revenues and expenditures are removed from the operating fund, the Museum's operating revenue exceeded expenditures by \$290,295.

The Museum's fiscal year 2004-2005 City appropriation was reduced 29% to \$1,290,000, due to the emergency advance awarded in fiscal year 2003-2004. For fiscal year 2004-2005, the Museum has projected a revenue surplus of \$3,878.

In our opinion, unless the Museum receives additional funding it will be necessary to cut back its operations significantly or discontinue operation completely, under the worst cast scenario.

FINDINGS AND RECOMMENDATIONS

Findings marked with an asterisk (*) indicate that the finding and related recommendation appeared in the previous Auditor General report. The date shown in parenthesis indicates the audit report in which the finding first appeared.

***1. Implement Record Keeping and Control of Accessioned Artifacts**

(June 30, 1990) The Museum has not inventoried its artifacts collection as stipulated in the Museum's contract with the City.

The City contract requires the Museum to complete a comprehensive inventory of the Museum's collection within two years of the effective contract date of November 1, 1999.

The Museum leaves itself vulnerable to theft if proper inventory controls are not implemented. Moreover, loss of insurance proceeds may occur if stolen artifacts cannot be verified for insurance claim purposes.

Museum personnel stated that major obstacles to conducting the inventory are the size of the project and the lack of skilled, trained personnel to handle the task.

We again recommend that the Museum comply with its contractual agreement and submit to the City a complete and comprehensive inventory of the artifacts collection.

***2. Implement Purchasing Procedures to Improve Control**

(June 30, 1991) The Museum does not have an established purchasing procedure. After testing a sample of disbursements, we determined that none conformed to sound internal controls. During our analysis of selected disbursements, we determined that the Museum:

- a) Could not document that purchases were approved prior to goods ordered and services engaged; and
- b) Received merchandise without counting and verifying quantities.

Effective internal control requires the receiving department perform an independent count of the delivered merchandise and note those quantities. An accounts payable employee should reconcile the vendor's invoice to the receiving documentation to properly determine the amount payable to the vendor.

Museum personnel stated a formal purchase order system is not needed because of the small size of their operation and limited staff. However, if the Museum does not implement corrective action it could make unauthorized purchases and vendor payments.

We again recommend that the Museum formally document and implement purchasing procedures that include the proper separation of duties over the ordering, approval process, receipt, storage, and distribution of merchandise and other assets.

***3. Establish a Prompt Payment Policy to Avoid Late Penalty Charges**

(June 30, 1993) The Museum does not have a written prompt payment policy and it does not prioritize vendor payments. As a result, the Museum continues to incur late payment charges.

During our examination of utility payments, we determined that the Museum paid unnecessary late payment charges of \$1,292.37 and \$780.17 on two invoices.

The payments of late charges are unnecessary expenditures. Good internal accounting controls include taking discounts for early payment of invoices, and avoiding late payment charges. Sound financial management practices maximize the use of revenue to support program expenditures.

We again recommend that the Museum establish a prompt payment policy and prioritize vendor invoices to prevent the billing and payment of late charges. We also recommend that the Museum take advantage of early payment discount opportunities.

4. Implement Controls Over Imprest Cash

The Museum does not maintain controls over its imprest cash. In addition, it co-mingles admissions receipts with imprest cash. During our examination we determined that:

- a) The fiscal year 2002-2003, imprest cash increased from a beginning balance of \$741.69 to an ending balance of \$3,822.51.
- b) The change fund established to provide cashiers with adequate amounts of change for daily sales decreased from \$2,718.50 to zero at the end of the same fiscal year. Of the \$2,718.50 change fund, only \$1,371.47 was recorded as transferred to imprest cash.
- c) The Museum staff used daily admissions cash receipts to reimburse the imprest cash box.
- d) Seven of the nine reimbursed receipts reviewed in the imprest cash box were for purchases in excess of \$25. Museum personnel indicated that imprest cash was to be used for expenditures totaling \$25.00 or less.
- e) A Museum Store purchase order, and an \$806.80 check request, marked "paid in cash" were found in the imprest cash box. The Museum could not provide an invoice for this purchase.

Good internal accounting controls require imprest cash activity to be properly controlled, documented, and approved.

The aforementioned weakness could result in the Museum making unauthorized imprest cash purchases. The co-mingling of cash receipts with imprest cash could result in a misappropriation of funds and minimize the identification of cash errors or shortages. Finally, the Museum could continue to misstate operating expenditures.

Museum staff indicated that written procedures do not exist and formal documentation is not needed because it is a small operation.

We recommend that the Museum establish written procedures governing the use and proper maintenance of an imprest cash fund. We also recommend the Museum deposit cash receipts intact, and discontinue the practice of using admissions receipts to reimburse the imprest cash fund. Finally, we recommend that imprest cash be used for purchases of \$25.00 or less.

5. Establish Controls Over Fixed Assets

The Museum does not perform an annual inventory. As a result, fixed assets valued in excess of \$4.2 million have not been counted annually, documented, and tagged.

According to the terms of the operating agreement between the City and the Museum, the City retains ownership of all personal property located on the Museum's premises. Therefore, all of the Museum's fixed assets should be properly tagged with a City of Detroit "inventory" tag and included in the City's Capital Assets System.

Effective inventory control requires the development and maintenance of accurate inventory records, which include performing an annual physical inventory. The absence of adequate inventory controls increases the likelihood of inventory loss due to misplacement or misappropriation.

Museum personnel stated it is not the policy of the Museum to inventory and tag its fixed assets.

We recommend that the Museum perform an annual physical inventory of its fixed assets, and ensure that assets are properly tagged with City identification and entered into the City's Capital Assets System.

NONCOMPLIANCE AND OTHER ISSUES

Revenue Weakness: During our review we noted that \$36,000 in cash receipts were not deposited within 48 hours. Although the Museum has a secure vault, and the facility is monitored 24 hours a day, the process of holding funds on-hand in excess of 48 hours affords the opportunity for cash receipts to be stolen, misplaced, and misused.

We recommend that the Museum deposit in the bank and record in the Museum's accounting system cash, checks, money orders or cash equivalents within 48 hours after receipt.

Annual Reporting: The Museum does not submit annual reports to various City agencies. According to the terms of the City Agreement, the Museum should complete a written report on the Museum's compliance with the terms of the City agreement within 90 days after each fiscal year ending June 30. The report should include financial, artifacts, and insurance information. The Museum should also report Museum fundraising activities, number of visitors to the Museum, and the number of public served by other Museum programs during the reporting period. Copies of the report should be submitted to the City Council, the City's Auditor General and to the Mayor. The agreement also stipulates, "The form of the report shall be prescribed by the City."

We recommend that the Museum submit annual reports to the City Council, Auditor General and the Mayor in accordance with the terms of the City Agreement. We also recommend that the City provide to the Museum the prescribed format of the report.

ATTACHMENT A

April 21, 2005

Joseph L. Harris, Auditor General
Office of the Auditor General
2 Woodward Avenue
Coleman A. Young Municipal Center, Room 208
Detroit, Michigan 48226

Dear Mr. Harris:

The following presents the Charles H. Wright Museum of African-American History's response for the indicated findings and related recommendations in the Audit of the Charles H. Wright Museum of African-American History dated November 2004, as prepared by the Office of the Auditor General.

Finding No. 1. Implement Record Keeping and Control of Accessioned Artifacts

Department's Response:

The Museum houses a collection of over 40,000 artifacts. Museum standards pertaining to the cataloging (inventory) of artifacts are complex and require skilled and trained personnel. Accredited institutions employ state of the art techniques to digitize its holdings for greater accessibility by its users. In December 2001, the Museum was awarded a grant by the Skillman Foundation to digitize a portion of its collections. To date, over 12,000 pieces have been completed and work is continuous. **Strategically, the Museum is committed to completing this process by June 2007 and additional funding to staff this project is being sought.**

Finding No. 2. Implement Purchasing Procedures to Improve Control

Department's Response:

The Museum has a strict purchasing policy. Since 2001, the Museum has implemented many new procedures and processes that have resulted in enhanced controls over spending and much improved financial results.

In general, purchases are preauthorized via budgeting controls. In addition to annual operating budgets, all programs, exhibitions, and events have specific spending budgets approved by a member of the executive team. Given the Museum's lack of financial reserves, staff is also required to seek final authorization to spend from the CFO even on previously approved budget items. Recurring purchases of building supplies and services are executed using a standard purchase order process. On a monthly basis, detailed

expenditure reports are submitted to the Board's Executive Committee and Finance Committee. In management's opinion, these compensating controls greatly minimize the risk of unauthorized purchases.

Management has made progress in preparing written policies and standards, however, the absence of manuals should not be interpreted that controls are not in place. **The Museum has a strategic goal to revise and update policy and procedure manuals, including purchasing guidelines, by June 2006.**

With regards to procedures for receiving merchandise, effective immediately the staff has been directed to provide packing slips or other evidence of receipt to the Finance Department as additional authorization for the payment of invoices.

Finding No. 3. Establish a Prompt Payment Policy to Avoid Late Penalty Charges

Department's Response:

The Museum has a prompt payment policy, however, cash flow challenges do not allow the Museum to conform to the guidelines. Our cash management process ensures that staff, withholding taxes, benefits, banks, and utilities receive prioritized payments. **As cash flow improves, the Museum fully intends to make timely payments and to take advantage of early payment discounts when available.**

Finding No. 4. Implement Controls Over Imprest Cash

Department's Response:

Since 2001, the Museum has implemented improved controls over its petty cash system by consolidating all reimbursement activities to the Finance Department. To address specific findings noted by the Auditor:

- a) Imprest cash increased due to a consolidation of multiple departmental petty cash funds into a single fund (see note b. below).
- b) The change fund in this finding was temporarily established for the 2001 African World Festival. When reconciled in 2002, the balance of the fund was consolidated into the Finance Department petty cash fund (see note a. above) and an un-reconciled balance was charged to miscellaneous expense. Since this entry, petty cash has been reconciled each quarter without exception.
- c) To reimburse the fund, the Museum used funds prepared for bank deposit and properly recorded the necessary journal entries to reflect the transfer of funds. The Auditor has suggested the Museum replace reimbursement funds with a check made payable to "cash" in the bank deposit. **The Museum will implement this procedure effective immediately.**

- d) **Museum management has reviewed the current reimbursement level (\$25.00) for petty cash and has agreed to raise the maximum reimbursement to \$50.00, effective immediately.** Management reserves the right to authorize occasional reimbursements above this level when circumstances deem it necessary.
- e) This resulted from a one time situation when merchandise was received C.O.D. The vendor did not invoice the Museum, and staff was not requested to and did not forward appropriate receiving documentation. These documents were maintained in the ordering department but were not available to the auditor during testing. **The Museum's current policy requires a formal check request to be prepared, along with the vendor's quote and/or preliminary invoice, for all C.O.D. orders.** Items received at the dock without an approved check request are returned to the vendor.

An updated and complete petty cash reimbursement policy and process will be included in the Museum's forthcoming manuals (due June 2006).

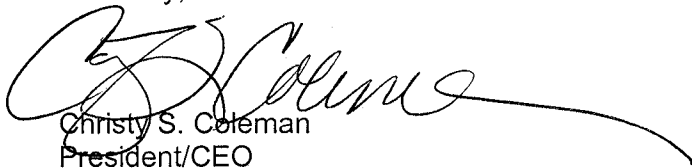
Finding No. 5. Establish Controls Over Fixed Assets

Department's Response:

The Museum's current Strategic Plan indicates an inventory of fixed assets is to be completed by October 2005. Thereafter, because of the resources required, an inventory of fixed assets will be done on a bi-annual basis.

The operating agreement between the Museum and the City does not stipulate that all assets are tagged. Furthermore, given the nature of museum's and conservation best practices, artifacts are identified with a separate cataloging system. However, the Museum will work with the City's Finance Department to provide inclusion of assets in the City's fixed asset system without compromising the artistic or display integrity of the asset.

Sincerely,



Christy S. Coleman
President/CEO

Copy: Rod Gillum, Chairman – Board of Trustees
Sean Werdlow, Chief Financial Officer – City of Detroit
LaFell Peoples, George Johnson & Company